

CITY OF NATIONAL CITY
TRANSPORTATION DEVELOPMENT ACT FUNDS

Annual Financial Report of the Transportation
Development Act ("TDA") Funds – Article 4

Year ended June 30, 2006

CITY OF NATIONAL CITY
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Development Act ("TDA") Funds- Article 4

For the Year Ended June 30, 2006

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To the Honorable Mayor and City Council
City of National City
National City

INDEPENDENT AUDITORS' REPORT

We have audited the TDA funds financial statements of the Article 4 Transportation Development Act ("TDA") funds administered and disbursed by the City of National City, California (the "City") as of June 30, 2006 and the related statements of revenues, expenses and changes in financial position and cash flows for the year then ended. These TDA funds financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these TDA funds financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the TDA funds financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the TDA funds financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, the TDA funds financial statements present only the TDA funds referred to in the first paragraph and are not intended to present the financial position and results of operations of the City in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the TDA funds financial statements referred to above present fairly, in all material respects, the financial position of the aforementioned TDA funds of the City of National City as of June 30, 2006 and the results of operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the National City Transit will continue as a going concern. As discussed in Note 4 to the financial statements, National City Transit's primary revenue source may be terminated which raises substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of uncertainty.



To the Honorable Mayor and City Council
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In accordance with *Government Auditing Standards*, we have also issued a report dated November 30, 2006 on our consideration of the City's internal control structure over TDA funds financial reporting and our test of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters governing TDA funds. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Mayer Hoffman McCann P.C.

Irvine, California
November 30, 2006

CITY OF NATIONAL CITY
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Statement of Net Assets
June 30, 2006

Assets

Current assets:

Cash and investments (note 2)	\$ 200,217
Accounts receivable	2,329
Due from other governments	95,835
Prepaid expenses	45,132
Inventory	<u>129,443</u>
Total current assets	<u>472,956</u>

Noncurrent assets:

Capital assets:

Land	900,000
Building and improvements	1,997,630
Automotive equipment	4,661,259
Equipment	<u>378,694</u>
Total capital assets	<u>7,937,583</u>
Less accumulated depreciation	<u>(2,861,959)</u>
Total capital assets, net	<u>5,075,624</u>
Total assets	<u>5,548,580</u>

Liabilities and Net Assets

Current liabilities:

Accounts payable	106,357
Accrued expenses	24,578
Compensated absences	<u>48,676</u>
Total current liabilities	<u>179,611</u>

Net assets:

Invested in capital assets, net of related debt	5,075,624
Unrestricted net assets	<u>293,345</u>
Total net assets	<u>\$ 5,368,969</u>

See accompanying notes to the financial statements.

CITY OF NATIONAL CITY

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Statement of Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2006

Operating revenues:	
Passenger fares	\$ 1,287,218
Total operating revenues	<u>1,287,218</u>
Operating expenses:	
Personnel services	1,535,253
Maintenance and operation	1,200,880
Insurance	460,713
Depreciation	<u>487,926</u>
Total operating expenses	<u>3,684,772</u>
Operating income (loss)	<u>(2,397,554)</u>
Nonoperating revenues (expenses):	
Local transportation funds	2,002,041
Investment income	4,401
Other revenue	<u>34,653</u>
Total nonoperating revenues (expenses)	<u>2,041,095</u>
Change in net assets	(356,459)
Net assets at beginning of year, as restated (note 3)	<u>5,725,428</u>
Net assets at end of year	<u>\$ 5,368,969</u>

See accompanying notes to financial statements.

CITY OF NATIONAL CITY
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Statement of Cash Flows
Year ended June 30, 2006

Cash flows from operating activities:	
Cash received from customers/ users and others	\$ 1,538,420
Cash paid to suppliers	(1,661,593)
Cash paid to employees	<u>(1,535,253)</u>
Net cash used for operating activities	<u>(1,658,426)</u>
Cash flows from investing activities:	
Purchase of capital assets	(66,705)
Interest received	<u>4,401</u>
Net cash used for investing activities	<u>(62,304)</u>
Cash flows from non-capital financing activities:	
Operating grants	2,002,041
Cash paid to City of National City	<u>(238,486)</u>
Net cash provided by non-capital financing activities	<u>1,763,555</u>
Net increase (decrease) in cash and investments	42,825
Cash and investments, beginning of year	<u>157,392</u>
Cash and investments, end of year	<u><u>\$ 200,217</u></u>
Reconciliation of operating income to net cash used for operating activities:	
Operating income (loss)	<u>\$ (2,397,554)</u>
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Depreciation	487,926
Accounts receivable	1,995
Due from other governments	243,860
Prepaid expenses	58,176
Inventory	9,991
Accounts payable and accrued expenses	(68,789)
Compensated absences	<u>5,969</u>
Total adjustments	<u>739,128</u>
Net cash used for operating activities	<u><u>\$ (1,658,426)</u></u>

Noncash investing, capital and financing activities

There were no noncash investing, capital or financing activities for the year ended June 30, 2006

See accompanying notes to the financial statements.

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Notes to Financial Statements

Year ended June 30, 2006

(1) Summary of Significant Accounting Policies

The Reporting Entity

The TDA funds financial statements are intended to present the financial position and results of operations and cash flows of only those transactions attributable to the Article 4 - Transportation Development Act ("TDA") funds administered and disbursed by the City of National City, California (the "City").

Fund Accounting

The accounts of the City are organized on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts, which are comprised of each fund's assets, liabilities, net assets, revenues and expenses, as appropriate. Government resources are allocated to and for individual funds based upon the purpose for which they are to be spent and the means by which spending activities are controlled.

The TDA Fund is classified as an enterprise fund type which is a Proprietary Fund. Enterprise funds use an economic resource measurement focus and are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs, including depreciation, of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the TDA funds financial statements.

Enterprise funds are accounted for using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and their expenses are recognized when they are incurred.

CITY OF NATIONAL CITY

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Notes to Financial Statements

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

Allocations of Article 4 local transportation funds are voluntary nonexchange transactions received from other governments that are not in the form of reimbursement grants. The entitlement of the recipient government for the receipt of these funds is not based upon the recipient government first incurring allowable expenses. These amounts are recorded as revenue when the recipient government becomes entitled to the allocation (i.e., the amounts can be accessed without further qualification or approval by the party holding the funds on behalf of the recipient government). If the amounts currently accessible to the recipient government are held by another party, these amounts would be recognized as revenue and an asset (e.g., deposits, etc.) when the recipient government has met all of the conditions entitling it to the funds. Deferred revenue is not recorded in either the fund financial statements or in the government-wide financial statements for receipt of allocations prior to the recording of related expenses. In some cases the amounts not spent within a specified number of years (the *spending period*) must be returned to the providing agency. The requirement to return unspent funds within the spending period is not considered to be a requirement pertaining to the eligibility of funding and does not effect the recognition of revenue for this funding. This is because there is no requirement to spend the allocated resources in specific amounts or proportions for each of the fiscal years covered by the spending period. The entire allocation may be spent in any of the fiscal years covered by the spending period. Any amounts returned at the end of the spending period are required by generally accepted accounting principles to be recorded at that time as an *expense*.

(2) Cash and Investments

Cash and investments of the TDA at June 30, 2006 are classified in the accompanying financial statements as follows:

Statement of net assets:

Cash and investments	<u>\$200,217</u>
Total cash and investments	<u>\$200,217</u>

Cash and investments at June 30, 2006 consist of the following:

Investment in the City of National City's pooled cash and investments	<u>\$200,217</u>
Total cash and investments	<u>\$200,217</u>

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Notes to Financial Statements

(Continued)

(2) Cash and Investments, (Continued)

Investments Authorized by the California Government Code and the City's Investment Policy

The table below identifies the investment types that are authorized for the City of National City by the California Government Code and the City's investment policy. The table also identifies certain provisions of the California Government Code (or the City's investment policy, if more restrictive) that address interest rate risk and concentration of credit risk.

<u>Investment Types Authorized by State Law</u>	<u>Authorized By Investment Policy</u>	<u>*Maximum Maturity</u>	<u>*Maximum Percentage Of Portfolio</u>	<u>*Maximum Investment in One Issuer</u>
Local Agency Bonds	Yes	5 years	None	None
U.S. Treasury Obligations	Yes	5 years	None	None
U.S. Agency Securities	Yes	5 years	None	None
Banker's Acceptances	Yes	180 days	40%	30%
Commercial Paper	Yes	270 days	25%	10%
Negotiable Certificates of Deposit	Yes	5 years	30%	None
Repurchase Agreements	Yes	1 year	None	None
Reverse Repurchase Agreements	Yes	92 days	20% of base value	None
Medium-Term Notes	Yes	5 years	30%	None
Mutual Funds	Yes	N/A	15%	10%
Money Market Mutual Funds	Yes	N/A	20%	10%
Mortgage Pass-Through Securities	Yes	5 years	20%	None
County Pooled Investment Funds	Yes	N/A	None	None
Local Agency Investment Fund (LAIF)	Yes	N/A	None	None
JPA Pools (other investment pools)	Yes	N/A	None	None

* Based on state law requirements or investment policy requirements, whichever is more restrictive.

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Notes to Financial Statements

(Continued)

(2) Cash and Investments, (Continued)

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. Information about the sensitivity of the fair values of the City's investments to market interest rate fluctuations is provided in the City of National City's Comprehensive Annual Financial Report.

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The minimum rating required by the California Government Code or the City's investment policy and the actual rating as of year end for each investment type is presented in the City of National City's Comprehensive Annual Financial Report.

The TDA had no investments at June 30, 2006.

The cash resources of the TDA funds are combined in the City's checking and savings accounts and in the City's pooled investments. Pooled cash and investment are stated at fair value at June 30, 2006.

Investment policies and associated risk factors applicable to the TDA's funds are those of the City of National City and are included in Note 2 of the City's Comprehensive Annual Financial Report.

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Notes to Financial Statements

(Continued)

(3) Restatement of Net Assets

The basic financial statements reflect the following prior period adjustment to beginning net assets:

Net assets at beginning of year, as previously reported	\$5,464,587
To record the accrual of intergovernmental revenue earned in the prior year	<u>260,841</u>
Net assets at beginning of year, as restated	<u>\$5,725,428</u>

(4) Going Concern

On November 16, 2006, at a special joint meeting of the board of directors for the Metropolitan Transit System (MTS), San Diego Transit Corporation, and San Diego Trolley Inc., it was determined that the operational responsibility for National City Transit services may be transferred to MTS. In a Memorandum of Understanding (MOU) MTS agreed to continue payment of the rent, management fee, and overhead until March 31, 2007. On December 14, 2006 the board approved the transfer of operational responsibility to MTS effective March 4, 2007, and plans to discontinue allocations payment to National City Transit which to fund operations. The board will appoint a transition team to work with National City to assist with the transfer of the transit services and direct staff to continue to meet with National City representatives to discuss resolution of matters related to the National City Transit's property.



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To the Honorable Mayor and City Council
City of National City
National City

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

We have audited the TDA Fund financial statements of the Article 4 Transportation Development Act ("TDA") funds administered and disbursed by the City of National City, California (the "City") as of and for the year ended June 30, 2006 and have issued our report thereon dated November 30, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the TDA Fund financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving internal control over financial reporting that we have reported to management in a separate letter dated November 30, 2006.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's TDA Fund financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, including the requirements governing the TDA funds as described in Sections 6666 and 6667 of Subchapter 2, Article 5.5 of the California Code of Regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



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This report is intended solely for the information of the City Council, City management, the San Diego Association of Governments and the State Controller's office and is not intended to be and should not be used by anyone other than these specified parties.

Nayer Hoffman McCann P.C.

Irvine, California
November 30, 2006